No. 06-147

IN THE

Supreme Court of the United States

AT HOME CORPORATION,
Petitioner,

v.

COX COMMUNICATIONS, INC., COX @HOME, INC., COMCAST CORPORATION, COMCAST ONLINE COMMUNICATIONS, INC., COMCAST PC INVESTMENTS, INC., BRIAN L. ROBERTS, AND DAVID M. WOODROW,
Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Second Circuit

RESPONDENTS COX COMMUNICATIONS, INC. AND COX @HOME, INC.'S BRIEF IN OPPOSITION

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August 30, 2006

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(3)

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COUNTERSTATEMENT OF QUESTION PRESENTED

Did the United States Court of Appeals for the Second Circuit properly hold that, under Section 16(b) of the Securities Exchange Act of 1934 (15 U.S.C. § 78p(b)), the Complaint failed to plead the required "matching" purchase and sale of At Home Corporation ("At Home") stock within a period of less than six months by Cox Communications, Inc. and Cox @Home, Inc. (collectively, "Cox") where: (a) the relevant Securities and Exchange Commission ("SEC") regulations provide that a put option exercised solely at its fixed price component (like the put option at issue here) can give rise to a Section 16(b) "sale" only on the date that it is established; and (b) the establishment date of the put was more than thirteen months before the alleged matching purchase?

CORPORATE DISCLOSURE STATEMENT

Pursuant to Supreme Court Rule 29.6, respondents Cox Communications, Inc. ("CCI") and Cox @Home, Inc. ("Cox @Home") state that, through Cox Holdings, Inc. and Cox DNS, Inc., CCI is an indirect wholly-owned subsidiary of Cox Enterprises, Inc., which is a privately held corporation. Cox @Home is a wholly-owned subsidiary of CCI.

TABLE OF CONTENTS

Page

COUNTERSTATEMENT OF QUESTION PRESENTED i

CORPORATE DISCLOSURE STATEMENT ii

TABLE OF AUTHORITIES iv

BRIEF IN OPPOSITION 1

I. PERTINENT STATUTORY AND REGULATORY PROVISIONS 4

II. STATEMENT OF THE CASE 5

A. Allegations Of The Complaint 5

B. Transfer And Dismissal Of The Action 7

C. The SEC Determines That The District Court Should Be Affirmed 9

D. The Second Circuit Affirms The District Court 11

III. REASONS THAT THE PETITION SHOULD BE DENIED 12

A. There Is No Circuit Split Or Issue Of Widespread Application In This Case Demanding The Court's Attention 13

B. The Second Circuit Correctly Determined That The Only Section 16(b) Sale Occurred On The March 2000 Put's Establishment Date 14

C. The Bondholders Present No Valid Basis To Reverse The Second Circuit 20

CONCLUSION 26

APPENDIX A 1a

APPENDIX B 35a

TABLE OF AUTHORITIES

CASES **Page**

At Home Corp. v. Cox Commc'ns, Inc., Civ. A. No. 02-1486-JJF, 2003 WL 22350925 (D. Del. Oct. 8, 2003) 8
At Home Corp. v. Cox Commc'ns, Inc., 340 F. Supp. 2d 404 (S.D.N.Y. 2004) ..... *passim*
At Home Corp. v. Cox Commc'ns, Inc., 446 F.3d 403 (2d Cir. 2006) ..... *passim*
Auer v. Robbins, 519 U.S. 452 (1997) 19
Chevron U.S.A. v. Natural Res. Def. Council, 467 U.S. 837 (1984) 11
Cioffi v. Averill Park Central Sch. Dist. Bd. of Educ., 444 F.3d 158 (2d Cir. 2006) 22
City of Springfield, Mass. v. Kibbe, 480 U.S. 257 (1987) 20, 22
Davenport v. Harry N. Abrams, Inc., 249 F.3d 130 (2d Cir. 2001) 20, 22
Kern County Land Co. v. Occidental Petroleum Corp., 411 U.S. 582 (1973) 25
Lerner v. Millenco, L.P., 23 F. Supp. 2d 337 (S.D.N.Y.), *recon. denied*, 23 F. Supp. 2d 345 (S.D.N.Y. 1998) 8
Levy v. Clearwater Fund IV, Ltd.., No. Civ. A. 99-004-SLR, 2000 WL 152128 (D. Del. Feb. 2, 2000) 8
Levy v. Oz Master Fund, Ltd., No. Civ. 7148, 2001 WL 767013 (S.D.N.Y. July 9, 2001) 8, 15
Press v. Quick & Reilly, Inc., 218 F.3d 121 (2d Cir. 2000) 19
Schaffer v. CC Invs., LDC, 280 F. Supp. 2d 128 (S.D.N.Y.), *recon. granted in part*, No. 99-2821, 2003 WL 22480052 (S.D.N.Y. Oct. 31, 2003) 8, 23

TABLE OF AUTHORITIES—Continued

STATUTES **Page**

15 U.S.C. § 78p(b) (Securities Exchange Act of 1934, Section 16(b)) ..... *passim*
28 U.S.C. § 1367(c) 5

RULES AND REGULATIONS

17 C.F.R. § 240.16a-1(c) (SEC Rule 16a-1(c)) 4, 9
17 C.F.R. § 240.16a-1(h) (SEC Rule 16a-1(h)) ... 4, 10, 14
17 C.F.R. § 240.16b-6(a) (SEC Rule 16b-6(a)) ..... *passim*
17 C.F.R. § 240.16b-6(b) (SEC Rule 16b-6(b)) .... *passim*
SUP. CT. R. 10(c) 12

OTHER AUTHORITIES

Brief Of The Securities And Exchange Commission, *Amicus Curiae*, Submitted To The Second Circuit Court of Appeals on February 9, 2006 ..... *passim*
Ownership Reports and Trading By Officers, Directors and Principal Security Holders, Exchange Act Release No. 28,869, 56 Fed. Reg. 7242 (Feb. 21, 1991) 9, 16

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On Petition for a Writ of Certiorari to the United States Court of Appeals for the Second Circuit

RESPONDENTS COX COMMUNICATIONS, INC. AND COX @HOME, INC.'S BRIEF IN OPPOSITION

This case involves an unfounded attempt by former At Home bondholders (the "Bondholders")—to whom that defunct corporation's claims were transferred—to manufacture liability against Cox under the federal short-swing profits statute, i.e., Section 16(b) of the Securities Exchange Act of 1934. Section 16(b) imposes liability against a corporate insider *only if* the insider engages in a "matching" purchase *and* sale of company securities *within a period of less than six months*. The Second Circuit, the Southern District of New York, and the SEC (in an *amicus curiae* brief requested by the Second Circuit) each properly determined that the Bond-

holders' Section 16(b) claims should be dismissed as a matter of law because the Bondholders failed to plead that Cox engaged in matching transactions in At Home stock within the proscribed time period.

The "hybrid" put option in this case (i.e., an option to sell with both a fixed and a floating price component[1]) granted Cox the right to sell its shares of At Home stock to At Home's controlling stockholder, AT&T Corp. ("AT&T"), at the greater of the fixed price of $48 a share or a floating market price. This put option (the "March 2000 Put" or "Put") was established on March 28, 2000, and its subsequent exercise price was *solely* its $48 *fixed* price. The Second Circuit, the Southern District of New York, and the SEC each agreed that SEC rules require that the Put be treated as a Section 16(b) sale solely on its *establishment* date (when the primary potential for abuse of the option existed), and not, as the Bondholders argued below, on or after the Put's subsequent exercise date. Because the only conceivable matching "purchase" in this case occurred on May 18, 2001—*well over six months after* the March 28, 2000 deemed sale date—the courts below held that the Bondholders failed to state a claim against Cox.

As explained in more detail below, the Bondholders' petition for *certiorari* should be denied. First, there is no

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[1] A put option is an option that gives its holder the right, but not the obligation, to sell shares of stock to the other party to the put at a price determined by the option's terms. In the case of a hybrid option, whether the option is exercised at the fixed or the floating component depends upon the market price of the underlying security. Where a hybrid put option contains a provision (like the put in this case) specifying that the exercise price will be the greater of the fixed price or the floating price, the fixed price component necessarily sets a minimum price. If the market price following exercise (at the time of the closing of the floating component's market pricing window) is below the price set in the fixed component (as here), then the exercise price of the hybrid put option will be the fixed price.

circuit split regarding the issues addressed in the Second Circuit's opinion; the Second Circuit is the only appellate court to have addressed the Section 16(b) treatment of a hybrid security. Further, there is no disagreement between the SEC (the agency charged with administering Section 16) and the Second Circuit, as the SEC also concluded in its *amicus* brief that the District Court's dismissal order should be affirmed.

Second, the Second Circuit's opinion was correct and, indeed, was required by the relevant SEC regulations governing the Section 16(b) treatment of derivative securities. Those regulations were designed to serve Section 16(b)'s statutory purpose of preventing corporate insiders from making short-swing profits by using non-public information. The SEC amended its regulations in 1991 to close an easily-exploitable loophole, which the Bondholders' position in the courts below would have reopened.

Finally, the Bondholders' remaining arguments for granting *certiorari* are meritless, including their newly raised "dual sale" argument that is the focus of their petition. Before this Court, the Bondholders have abandoned (and indeed do not even mention) the argument that they unsuccessfully presented to the Second Circuit, the District Court, and the SEC. Specifically, the Bondholders argued (and pled in their Complaint) that the March 2000 Put was a sale *only* after it was exercised in January 2001, and that it could not be treated as a sale on its March 28, 2000 establishment date. The Bondholders now *concede* that the Put's establishment was a sale, but also argue that a *second* sale should be recognized as a result of the Put's exercise. This new "dual sale" argument was never properly raised below, and is directly contrary to SEC regulations. In fact, the SEC explained in its *amicus* brief that the exercise of a hybrid put at a fixed price is *not* a Section 16(b) sale under its rules.

I. PERTINENT STATUTORY AND REGULATORY PROVISIONS

- Section 16(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78p(b):

  For the purpose of preventing the unfair use of information which may have been obtained by such beneficial owner, director, or officer by reason of his relationship to the issuer, any profit realized by him from any purchase and sale, or any sale and purchase, of any equity security of such issuer (other than an exempted security) . . . within any period of less than six months, . . . shall inure to and be recoverable by the issuer . . .

- SEC Rule 16a-1(c), 17 C.F.R. § 240.16a-1(c):

  The term derivative securities shall mean any option . . . with an exercise or conversion privilege at a price related to an equity security . . . , but shall not include: . . .

  (6) Rights with an exercise or conversion privilege at a price that is not fixed . . . .

- SEC Rule 16a-1(h), 17 C.F.R. § 240.16a-1(h):

  The term put equivalent position shall mean a derivative security position that increases in value as the value of the underlying equity decreases, including, but not limited to, a long put option and a short call option position.

- SEC Rule 16b-6(a), 17 C.F.R. § 240.16b-6(a):

  [T]he establishment of or increase in a put equivalent position . . . shall be deemed a sale of the underlying securities for purposes of section 16(b) of the Act . . . .

- SEC Rule 16b-6(b), 17 C.F.R. § 240.16b-6(b):[2]

  The closing of a derivative security position as a result of its exercise . . . shall be exempt from the operation of section 16(b) of the Act, and the . . . disposition of underlying securities at a fixed exercise price due to the exercise of a put equivalent position shall be exempt from the operation of section 16(b) of the Act . . . .

II. STATEMENT OF THE CASE

The Bondholders have petitioned for a writ of *certiorari* for review of the Second Circuit's decision affirming the Southern District of New York's dismissal with prejudice of the Bondholders' Section 16(b) claims. The courts below held that the sole Section 16(b) claim asserted against Cox (the first cause of action) failed to plead that Cox engaged in a "matching" purchase and sale of At Home stock within a period of less than six months, and thus did not state a Section 16(b) claim against Cox. *See At Home Corp. v. Cox Commc'ns., Inc.*, 340 F. Supp. 2d 404, 410 (S.D.N.Y. 2004) (Pet. App. 17a-30a), *aff'd*, 446 F.3d 403 (2d Cir. 2006) (Pet. App. 1a-13a).

A. Allegations Of The Complaint.

The sole Section 16(b) cause of action against Cox[3] alleges that Cox's January 2001 *exercise* of the March 2000 Put

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[2] The Bondholders omitted this rule from their appendix, and therefore Cox has included it in its appendix. *See* Cox App. 35a.

[3] The Bondholders also named as defendants Comcast Corporation, Comcast Online Communications, Inc. and Comcast PC Investments, Inc. (collectively "Comcast") and Brian L. Roberts, as well as David M. Woodrow, a former Cox executive and former At Home director. In addition to the Section 16(b) claims against Cox and Comcast, the Bondholders also asserted a state law fiduciary duty claim against all defendants, which the District Court dismissed without prejudice on December 3, 2004 pursuant to 28 U.S.C. § 1367(c).

constitutes a "sale" of At Home stock that can be matched with an alleged purchase, i.e., Cox's subsequent entry into a Share Issuance Agreement with AT&T on May 18, 2001, to create liability under Section 16(b). Although Cox owned only approximately 8.3% of At Home's Series A common stock when the Put was established on March 28, 2000, the Complaint alleges that Cox is nevertheless subject to Section 16(b) as a statutory insider because Cox and Comcast together purportedly held a greater than 10% stock ownership stake as a "group." Compl. ¶¶ 11-12, Pet. App. 39a.

As the Complaint concedes, the Put contained a "hybrid pricing mechanism" (Compl. ¶ 54, Pet App. 53a) that, at any time from January 1, 2001 through June 4, 2002, allowed Cox to require AT&T to purchase up to approximately $1.4 billion of At Home stock from Cox at the greater of:

- the fixed price of "$48 per share" (Compl. ¶ 45, Pet. App. 49a); or
- "the average per share trading price of At Home common stock" over a specified period before and after the exercise date (the "floating component's market pricing window") (*id.*).

The March 2000 Put capped the maximum consideration that Cox could receive from AT&T at approximately $1.4 billion, which was the amount payable to Cox if it sold all its At Home shares to AT&T at the fixed price of $48 a share. Compl. ¶¶ 11, 44, Pet. App. 39a, 49a. Thus, the Put's fixed price component allowed Cox to sell a fixed number of shares to AT&T at $48 per share. *Id.* ¶ 45, Pet. App. 49a. Even if the Put's exercise price were a higher floating price, Cox would still receive the same amount of total consideration, but would be able to sell fewer shares to AT&T than under the fixed price component. *Id.*[4]

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[4] The March 2000 Agreements provided Comcast with essentially the same put right, although the Comcast put had a higher total consideration

On January 11, 2001, CCI exercised the Put and notified AT&T of its election to sell all the At Home common stock, owned directly or indirectly by it or Cox @Home, to AT&T. Compl. ¶ 52, Pet. App. 52a. Because the average market price during the relevant period was less than $48 per share,[5] the exercise price for Cox's At Home stock was solely the fixed price of "$48 per share pursuant to the [Put's] hybrid pricing mechanism." *Id.* ¶ 54, Pet. App. 53a.

The Complaint alleges that the purported matching "purchase" occurred on or about May 18, 2001, when AT&T and Cox entered into an agreement (the "Share Issuance Agreement"), pursuant to which Cox would retain its At Home stock and AT&T would be deemed to have satisfied the March 2000 Put in full. Compl. ¶ 56, Pet. App. 53a.[6] Cox entered into this Share Issuance Agreement *over thirteen months after* the establishment of the March 2000 Put on March 28, 2000. *Id.* ¶¶ 43, 56, Pet. App. 49a, 53a.

B. Transfer And Dismissal Of The Action.

The Bondholders originally filed this action in the United States District Court for the District of Delaware. On September 24, 2002, that court held that the Bondholders had "engage[d] in forum shopping [by] attempting to force this

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limit (and therefore under the fixed price component a higher number of shares).

[5] At Home stock closed at "$7.72 per share" on January 11, 2001, and at "$6.00 per share" on February 2, 2001. Compl. ¶¶ 53, 54, Pet. App. 53a.

[6] The Bondholders contended that the Share Issuance Agreement constituted a cancellation of the March 2000 Put (Compl. ¶¶ 55, 56, Pet. App. 53a), which they claimed was a deemed purchase pursuant to Rule 16b-6(a). The defendants disputed that the Put was cancelled, asserting that after its exercise, the Put ceased to be a unilateral option contract within the scope of Rule 16b-6(a), and instead became a bilateral contract. Neither court below ruled on this issue.

case into the District of Delaware,"[7] and transferred the action to the Southern District of New York. *At Home Corp. v. Cox Commc'ns Inc.*, Civ. A. No. 02-1486-JJF, 2003 WL 22350925, at *2 (D. Del. Oct. 8, 2003).

Following the transfer, Cox and Comcast moved to dismiss the Section 16(b) causes of action against them. On August 12, 2004, the District Court granted defendants' motions. Relying upon three prior Southern District of New York cases that had decided the Section 16(b) issue presented in the first cause of action in a manner favorable to defendants,[8] the District Court dismissed that claim. It held that the March 28, 2000 establishment of the Put was "the only sale-equivalent event" pled in the Bondholders' Complaint. Recognizing that this event "occurred more than six months before the only conceivable purchase" on May 18, 2001, the District Court ruled that the Bondholders' first cause of action failed to state a Section 16(b) claim against Cox and Comcast. Pet. App. 27a.[9]

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[7] The Bondholders originally filed in Delaware in hopes of availing themselves of a District of Delaware case, *Levy v. Clearwater Fund IV, Ltd.*, No. Civ. A. 99-004-SLR, 2000 WL 152128 (D. Del. Feb. 2, 2000). That case ignored the importance of the fixed price component of a hybrid put and has now been thoroughly discredited by the SEC in its *amicus* brief, the Second Circuit, and multiple cases in the Southern District of New York. *See* cases cited n.8 *supra*. The Bondholders have now abandoned their reliance on this inapposite decision, which dealt with the exercise of a hybrid option at a *floating price* (unlike here) and, in any event, does not support the Bondholders' new "dual sale" argument.

[8] *See Lerner v. Millenco, L.P.*, 23 F. Supp. 2d 337 (S.D.N.Y.), *recon. denied*, 23 F. Supp. 2d 345 (S.D.N.Y. 1998); *Levy v. Oz Master Fund, Ltd.*, No. Civ. 7148, 2001 WL 767013 (S.D.N.Y. July 9, 2001); *Schaffer v. CC Invs., LDC*, 280 F. Supp. 2d 128 (S.D.N.Y.), *recon. granted in part*, No. 99-2821, 2003 WL 22480052 (S.D.N.Y. Oct. 31, 2003).

[9] The District Court also dismissed a separate alternative Section 16(b) claim (the second cause of action) that the Bondholders asserted against Comcast only.

C. The SEC Determines That The District Court Should Be Affirmed.

On appeal, prior to the Second Circuit's affirmance of the District Court's dismissal of the Bondholders' Complaint, the Second Circuit requested the SEC to submit an *amicus curiae* brief. After soliciting the parties' views and meeting with their counsel, the SEC filed its *amicus* brief on February 9, 2006 ("SEC *Amicus* Brief"). *See* Cox App. 1a-34a. The SEC rejected the Bondholders' claim that the Put's exercise date, rather than its establishment date, should be deemed a Section 16(b) sale (Cox App. 13a-14a) and recommended that the District Court's ruling be affirmed (Cox App. 9a, 30a).

In reaching this conclusion, the SEC relied on the 1991 amendments to its Section 16(b) rules. Cox App. 10a-13a. The SEC explained that these amendments were specifically designed to eliminate the potential for an insider to easily circumvent Section 16(b) through the use of derivative securities:

> Before 1991, the purchase or sale of securities underlying a derivative security [such as a fixed price option][10] occurred on the exercise of the derivative, rather than upon its creation. In 1991, the Commission noted that this left "open a significant potential for short-swing abuse in trading derivative securities."

Cox App. 10a (quoting *Ownership Reports and Trading By Officers, Directors and Principal Security Holders*, Exchange Act Release No. 28,869, 56 Fed. Reg. 7242, 7250 (Feb. 21, 1991) ("1991 Release")).

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[10] As the SEC explained in its *Amicus* Brief, the term "derivative security" includes "'any option'" with an "'exercise or conversion privilege at a price related to any equity security, or similar securities with a value derived from the value of an equity security,'" and includes a "put equivalent position" such as a fixed price put option. Cox App. at 11a-12a (quoting 17 C.F.R. § 240.16a-1(c)).

The SEC then offered the following example of how an insider could use a fixed price put to profit under the pre-1991 rules:

> [A]n insider who knows of impending negative information can negotiate a fixed price put, enabling it to sell, after the negative information is released and the price falls, at the higher price. The insider unfairly uses the inside information by fixing the price when the derivative is created, not when it is exercised.

Cox App. 11a. Thus, by acquiring a put with a fixed price, an insider can obtain the same short-swing profit that it could by selling stock. Although these two events are equivalent, one event (the traditional sale) was a Section 16(b) sale under pre-1991 law and the other (the acquisition of the fixed price put) was not.

The SEC amended its rules in 1991 to address this disparity. Cox App. at 11a. Specifically, the amended rules provide that the *establishment* of a put equivalent position (such as a put with a fixed exercise price)[11] "'shall be deemed a sale of the underlying securities for purposes of section 16(b).'" Cox App. at 11a-12a (quoting 17 C.F.R. § 240.16b-6(a)). In contrast, under SEC Rule 16b-6(b), the *exercise* of an option at its fixed price is *not* a Section 16(b) sale, since its establishment has already been recognized as a sale. 17 C.F.R. § 240.16b-6(b).

The SEC applied these rules and their underlying policy rationale to the March 2000 Put to determine that its March

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[11] Rule 16a-1(h) defines a "put equivalent position" as "a derivative position that increases in value as the value of the underlying equity decreases . . . ." 17 C.F.R. 240.16a-1(h). As the SEC noted, a put with a fixed exercise price comes within this definition because it "increases in value as the price of the underlying stock decreases because the spread between the market price and the fixed exercise price increases." Cox App. 12a.

28, 2000 establishment was the only Section 16(b) sale attributable to the Put. The SEC first explained that, under its rules, a hybrid put instrument such as the March 2000 Put was equivalent to two puts: a fixed put and a separate floating put:

> In this case, the March 2000 [Put] presented [Cox] with [a] put[] with a fixed price of $48 paired with [a] put[] with a floating price based on a specified market average.

Cox App. at 13a (emphasis added).

The SEC then determined that because the hybrid Put's exercise price was solely its $48 fixed price, the Put's establishment constituted the sole deemed Section 16(b) "sale" under Rules 16b-6(a) and (b):

> In January 2001, with the market price far below $48, the defendants chose to exercise their puts at the fixed price. *The opportunity to abuse inside information existed only at the time the fixed exercise price was set. . . . Because the fixed price was used in this case, the establishment of the puts is when the six month trading period should begin.*

Cox App. 13a (emphasis added).

D. The Second Circuit Affirms The District Court.

Consistent with the SEC *Amicus* Brief and the deference to be accorded to the agency that administers a statutory provision,[12] the Second Circuit likewise determined that the March 2000 Put was a "'hybrid option,' because [its] pricing formula ha[d] both fixed and floating components" (Pet. App. 4a), and was cognizable as a Section 16(b) sale solely on March 28, 2000 (Pet. App. 8a).

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[12] *See generally Chevron U.S.A. v. Natural Res. Def. Council*, 467 U.S. 837 (1984).

The Second Circuit explained that two regulations compelled this result. Pet. App. 8a. First, Rule 16b-6(a) provides that "the *establishment* of . . . a put equivalent position shall be deemed a sale of the underlying securities for purposes of section 16(b) . . . ." 17 C.F.R. § 240.16b-6(a) (emphasis added). Second, Rule 16b-6(b) provides that "the *disposition* of underlying securities *at a fixed exercise price* due to the exercise of a put equivalent position shall be exempt from the operation of section 16(b) . . . ." 17 C.F.R. § 240.16b-6(b) (emphasis added).

The Second Circuit concluded that, "[r]ead together, the two rules treat the *acquisition* date of a put as the only sale date if the option is ultimately exercised according to a fixed price mechanism." Pet. App. 8a (italics in original; underline added). Therefore, the Second Circuit ruled that because the March 2000 Put was exercised solely at its $48 per share fixed price, the deemed sale occurred *only* on March 28, 2000, when the Put was established, and not on the later exercise date. Accordingly, the Second Circuit affirmed the District Court's decision that the Bondholders failed to plead matching Section 16(b) transactions by Cox. Pet. App. 8a-9a.

III. REASONS THAT THE PETITION SHOULD BE DENIED

There is no reason for the Court to grant *certiorari* in this case. Rule 10(c), on which the Bondholders rely in their petition (Pet. at 2), provides that this Court may grant a writ of *certiorari* to address an "important question of federal law that has not been, *but should be*, settled by this Court." SUP. CT. R. 10(c) (emphasis added). For the multiple independent reasons set forth below, there is no such question of federal law present in this case.

A. There Is No Circuit Split Or Issue Of Widespread Application In This Case Demanding The Court's Attention.

First, the Court need not grant *certiorari* because there is no circuit split involving any issue presented in this case; the Second Circuit is the only Court of Appeals to have addressed these issues.[13] Moreover, the District Court (citing three prior district court decisions) and the SEC (in its *Amicus* Brief) agreed with the Second Circuit that the Bondholders' Section 16(b) claims should be dismissed. In contrast, the Bondholders fail to cite a single case that supports reversing the Second Circuit's ruling, and there is none.

Second, by the Bondholders' own admission, this case does not involve issues of widespread application to which this Court should devote its scarce judicial resources. Throughout the course of this litigation the Bondholders have taken great pains to argue that the March 2000 Put was entirely different from any other instrument, and that rules applicable to other hybrid derivatives thus could not be applied to it:

- "[T]his was no run of the mill put." Compl. ¶ 44, Pet. App. at 49a.
- "[P]recedent . . . simply does not 'work' when applied to the *unique instrument* at issue here . . . ." Appellant's Br. at 24 (emphasis added).
- The March 2000 Put is different from "any instrument in any other reported case of which we are aware . . . ." Appellant's Br. at 37.

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[13] In fact, as explained in Section C below, the principal disagreement at this point seems to be between the position that the Bondholders adopted in their Complaint and argued below (i.e., that there was *one* Section 16(b) sale occurring after exercise of the Put), and the belatedly devised and inconsistent position that they now seek to press before this Court (i.e., that there were *two* Section 16(b) sales).

- "This is not a typical put." Transcript of October 17, 2005 Oral Argument Before The Second Circuit ("Tr.") at 10. *See also id.* at 4 (the Put was "a unique instrument").

Although respondents believe the Bondholders' assertions regarding the uniqueness of the March 2000 Put are exaggerated, it is clear that the resolution of the issues in this case will hardly have "widespread application." In fact, there have been only a handful of published opinions dealing with hybrid derivative securities under Section 16(b) in the history of the statute. For these reasons and on the additional grounds set forth below, this Court should deny the petition.

B. The Second Circuit Correctly Determined That The Only Section 16(b) Sale Occurred On The March 2000 Put's Establishment Date.

This Court also need not grant *certiorari* because the decisions of the courts below were correct. Specifically, in affirming the dismissal with prejudice of petitioner's Section 16(b) claim against Cox, the Second Circuit reached a conclusion that is fully consistent with (i) the controlling statute and regulations, (ii) the relevant regulatory policy, and (iii) the SEC's *Amicus* Brief submitted to the Second Circuit supporting the dismissal of the Bondholders' Complaint.

First, the Second Circuit's decision to affirm the District Court is mandated by the relevant SEC regulations. At the outset, the Second Circuit properly concluded that the March 2000 Put was a hybrid option with *both* a $48 per share fixed component *and* a separate floating market price component. Pet. App. 4a. Below, the Bondholders essentially argued that the Put contained "no real fixed-price component" because, if market conditions had been different, the Put might have been exercised at a higher floating price for a lower number of shares due to its consideration cap. In properly rejecting

this argument as "erroneous" (Pet. App. 4a-5a), the Second Circuit stated:

> The prospect of a higher exercise price does not mean that there is no fixed-price component; *the prospect of a higher exercise price [through the floating component] is what makes the option a "hybrid" in the first place.*

Pet. App. 5a, n.2 (emphasis added).

Based on this determination, the Second Circuit then correctly applied the SEC's regulations to the fixed and floating components of the hybrid as, in effect, separate instruments contained within the March 2000 Put. Because the March 2000 Put contained a fixed price component, the Second Circuit necessarily concluded that it was a "put equivalent position,"[14] which is a form of "derivative security."[15] Pet. App. 8a & n.3.

The Second Circuit then examined the SEC rules pertaining to derivative securities. SEC Rule 16b-6(a) provides that, in light of the recognized equivalence between deriv-

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[14] As the Second Circuit noted, the SEC's definition of put equivalent position (Rule 16a-1(h)) "specifically covers put options such as those involved in this case" because through the "locked-in sale price" provided by the March 2000 Put's fixed price component, Cox "realized profit as At Home [stock] declined in price." Pet. App. 8a, n.3; 17 C.F.R. § 240.16a-1(h) ("put equivalent position" includes "derivative security position that increases in value as the value of the underlying equity decreases").

[15] The Bondholders argued below that the March 2000 Put was excluded from the definition of "derivative security" because it had an unexercised floating price component. This contention is meritless. "Rule 16b-6(a)(6) only 'excludes those securities *without a fixed exercise price.*'" *Oz Masterfund*, 2001 WL 767013 at *9 n.14 (quoting 1991 Release) (emphasis added). Thus, a hybrid (like the March 2000 Put), "which contains a fixed exercise price, would fall within the definition of 'derivative security.'" *Id.*

ative positions and their underlying equity securities (*see* 1991 Release, 56 Fed. Reg. at 7250), "the establishment of or increase in a put equivalent position . . . shall be deemed a sale of the underlying securities for purposes of section 16(b) of the Act." 17 C.F.R. § 240.16b-6(a). In contrast, Rule 16b-6(b) provides that, to avoid double liability:

> *the disposition* of underlying securities *at a fixed price* due to the exercise of a put equivalent position [such as a fixed put option] shall be *exempt* from the operation of section 16(b) . . . .

17 C.F.R. § 240.16b-6(b) (emphasis added).

The Second Circuit correctly determined that these rules "decide the case": (i) the establishment of the Put's fixed price component on March 28, 2000 was a sale under Rule 16b-6(a); (ii) the exercise of the fixed price component in January 2001 was a non-event under Rule 16b-6(b); and (iii) the mere existence of the floating price component did not lead to any Section 16(b) event because it was never exercised. *See* Pet. App. at 8a. *See also* 1991 Release, 56 Fed. Reg. at 7253 (rules require "the floating price derivative security" to be exercised to constitute a Section 16(b) event). Thus, the Second Circuit properly determined that, because the Put's "floating price [component] did not affect the calculation of the exercise price, the section 16(b) sale in this case occurred *only* with the acquisition of the [Put] . . . [on] March 28, 2000." Pet. App. 8a (emphasis added).

Second, the Second Circuit's decision is fully consistent with the policy rationale underlying the SEC's regulations. The Bondholders' proposed approach below of treating *the exercise* (rather than *the establishment*) of the fixed price component of the March 2000 Put as the relevant Section 16(b) event would reopen a loophole that the SEC closed with its 1991 revisions to its Section 16(b) rules. Under the Bondholders' approach (and the law prior to 1991), an insider with knowledge of an impending release of negative in-

formation could avoid Section 16(b) liability entirely by: (i) acquiring a hybrid put with a fixed component on Day 1 (a non-event under the Bondholders' approach); (ii) purchasing stock on Day 2 after the stock price had fallen (a non-matchable purchase under the Bondholders' approach); and (iii) waiting six months to exercise the fixed component of the hybrid put at the higher price (a non-matchable sale under the Bondholders' approach). Although the insider would wait six months to exercise the put at its fixed price, the insider could be certain of the put's *fixed* exercise price (and the existence of a locked-in profit) as of Day 1. Prior law, however, treated the exercise of the put as the relevant sale.

Current law—Rules 16b-6(a) and (b)—dictates that *only* the put's establishment is deemed a sale. These rules reflect the SEC's 1991 determination that the primary potential for abuse of an option with a fixed price component occurs at its establishment. Pet. App. 7a ("As to options with fixed price components, the SEC is of the view that the greatest risk of short-swing profiteering arises at the point in time nearest the establishment of the option.").

This is in contrast to a purely floating price option, which as the District Court explained, does not allow its holder to lock-in a profit until it is exercised, and accordingly is not treated as a Section 16(b) event until it is exercised. *See* Pet. App. 22a ("This type of option does not pose a risk of insider trading at the time of its creation because it does not lock in a price that may profitably diverge from the market price (i.e., once the inside information reaches the market).").

The below chart illustrates an insider's ability to insulate a short-swing profit from Section 16(b) liability under the approach that the Bondholders advocated in the courts below. The chart's shaded cells indicate the matching transactions that are present under the SEC rules and the Second Circuit's

holding, but are absent under the Bondholders' proposed treatment of hybrid options below.[16]

Opportunity For Abuse Created By Bondholders' Position

Date	Event	Bondholders' Position Below	Second Circuit Classification
Day one	Insider learns of an upcoming price decrease from existing $100 market price, and enters into hybrid fixed/floating put at the greater of **$100 a share** or a floating market price.	**Non-event.** The Bondholders ignore the acquisition of the fixed component.	**Matchable Sale** at $100 a share. Rule 16b-6(a) treats the establishment of the put as a sale.
The next day	Stock price drops to **$50 a share**, and the insider buys stock at that price.	**Non-Matchable Purchase** at $50 a share.	**Matchable Purchase** at $50 a share. The insider is liable for a $50 per share profit.

[16] Because the insider in the above scenario exercises the hybrid put solely at its fixed price component, the same result occurs regardless of whether the put contains a restriction (as the March 2000 Put did) on total consideration that would limit the number of shares that could be sold at the (irrelevant) floating price.

Date	Event	Bondholders' Position Below	Second Circuit Classification
Six months and one day later	Insider exercises put right and sells the stock originally bought at $50 for the **$100 a share fixed price,** making a **$50 per share profit**.	**Non-Matchable Sale** at $100 a share. The insider evades Section 16(b) liability because the purchase and sale are over six months apart.	**Non-event**. As noted above, a short-swing profit already is recoverable. The fixed price exercise is a non-event under Rule 16b-6(b).

Because the Bondholders have no answer for the loophole that would be created by the position that they took in the courts below, they now simply have abandoned that position and replaced it with their new "dual sale" argument. That argument asserts that the March 2000 Put should be treated as a sale both on its establishment date *and* on the last day of the irrelevant floating component's market pricing window. *See* Pet. at 9, 11 n.4. As established in Section C, however, the Bondholders' new "dual sale" argument was not properly raised below (and thus cannot be considered) and, in any event, is directly contrary to SEC rules.

Third, the Second Circuit's decision is in accord with the SEC's interpretation of its regulations in its *Amicus* Brief. Courts are "bound by the SEC's interpretations of its regulations in its amicus brief[s], unless they are 'plainly erroneous or inconsistent with the regulations.'" *Press v. Quick & Reilly, Inc.*, 218 F.3d 121, 128 (2d Cir. 2000) (citing *Auer v. Robbins*, 519 U.S. 452, 461-63 (1997).). Thus,

because the SEC reached the correct result consistent with its regulations, the Bondholders' petition should be denied.

C. The Bondholders Present No Valid Basis To Reverse The Second Circuit.

Certiorari should also be denied because the Bondholders have failed to present any basis for reversal of the Second Circuit and District Court's opinions.

First, as this Court has repeatedly held, a petition for *certiorari* should not be granted where a petitioner bases its argument on a contention not raised below. *See, e.g., City of Springfield, Mass. v. Kibbe*, 480 U.S. 257, 258 (1987) (dismissing writ as improvidently granted, where petitioner advocated position before the Supreme Court it did not press below); *see also Davenport v. Harry N. Abrams, Inc.*, 249 F.3d 130, 132 (2d Cir. 2001) (party cannot assert on appeal an argument that it failed to raise in the district court).

Here, the lynchpin of the Bondholders' request for *certiorari* is their new "dual sale" approach, whereby they claim the Put should be treated as a Section 16(b) "sale" *both* on its establishment date (March 28, 2000) *and* fifteen days after its exercise when the irrelevant floating component's market pricing window closed (February 2, 2001). Pet. at 9, 11 n.4. Ignoring their own Complaint and their arguments below, the Bondholders now assert that they "argued [this dual approach] to the Second Circuit." Pet. at 9.

To the contrary, the position that the Bondholders took in their Complaint[17] and consistently argued in their briefs

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[17] *See* Compl. ¶ 69, Pet. App. 58a (February 2, 2001 end of the floating component's market pricing window "was equivalent to a 'sale' by Cox" of At Home common stock).

before the District Court[18] and Second Circuit[19] was that the March 2000 Put was a Section 16(b) sale solely on or after its exercise. For example, in their reply brief before the Second Circuit, the Bondholders contended:

> *Only* fifteen days after Cox . . . gave notice to AT&T of [its] intent to exercise the option did this instrument become a derivative security and a 'sale' occur under Section 16(b).

Appellant's Reply Br. at 9 (emphasis added); *see also id.* at 12 ("[T]he Court should hold that . . . *the 'sale'* occurs . . . in this case [on] February 2, 2001.") (emphasis added). Indeed, at oral argument before the Second Circuit, the Bondholders expressly disavowed that the establishment of the March 2000 Put could be a sale:

> If your Honors go back and look at our complaint, the one thing that is *crystal clear* is we said [the Put's establishment] was *not a sale.* There was no event under 16(b) until *after* [Cox] gave notice [of exercise].

Tr. at 36 (emphasis added).

Consistent with these representations, the Second Circuit's opinion recounts that the Bondholders "argue[d] that, for the purposes of section 16(b), *the sale date was the exercise date*" of the March 2000 Put. Pet. App. 5a (emphasis

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[18] *See* Pet. App. 26a (reflecting that the Bondholders "argue[d] that [the district court] should . . . treat the [Put] as a purely floating derivative" cognizable as a sale only on its exercise date).

[19] *See* Appellant's Br. at 2 (asserting that "the district court erred . . . in holding that a Section 16(b) sale 'first' occurred when the Put . . . was created"); *see also* Appellant's Br. at 21 (second cause of action is relevant only "[i]f contrary to the facts and logic, this Court finds that a Section 16(b) sale occurred in March 2000, and not in February 2001").

added).[20] In their *certiorari* petition, however, the Bondholders do not even acknowledge that they made this argument below, and instead claim that they argued the dual sale approach "to the Second Circuit." Pet. at 9.

In any event, even if the Bondholders were somehow deemed to have raised the "dual sale" argument before the Second Circuit, that argument—only hinted at for the first time on appeal months after full briefing and oral argument in a supplemental reply letter brief[21]—would still have come far too late to be considered by this Court. *See Davenport*, 249 F.3d 132-33 ("argument [wa]s not properly asserted" because litigant "never argued [it] in district court"); *Cioffi v. Averill Park Cent. Sch. Dist. Bd. of Educ.*, 444 F.3d 158, 169 (2d Cir. 2006) (new argument raised for the first time in reply brief was untimely and deemed waived). Accordingly, *certiorari* should be denied. *City of Springfield, Mass. v. Kibbe*, 480 U.S. at 258.

Second, even if it had been properly raised (which it was not), the Bondholders' new "dual sale" argument fails on the

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[20] Because the Bondholders asserted that there was *only* one sale, the Second Circuit noted that "[i]f the section 16(b) sale occurred as of the granting of the [March 2000 Put], it is *undisputed* that At Home's short-swing [profit] claim fails as to Cox." Pet. App. 5a (emphasis added).

[21] Specifically, the Bondholders mentioned a "dual sale" only in a single passage in a letter to the Second Circuit replying to the SEC *Amicus* Brief. *See* Bondholders' Letter dated March 3, 2006 ("Reply Letter Br."). That letter never argued that the Second Circuit should adopt a "dual sale" position, but simply noted—incorrectly—that "[n]othing in the SEC's [brief] precludes a finding here" that two sales *might* be recognized. *See id.* at 4. Rather, the Bondholders' letter unequivocally took the position that "*the sale* occurred on February 2, 2001, when the price and number of shares subject to the [Put] were set for the first time." *Id.* at 2 (emphasis added). Given the Bondholders' failure to properly raise their new "dual sale" argument, the Second Circuit correctly elected not to address that argument in its decision. *See* Pet. App. 5a (recounting that the Bondholders argued that "the sale date was the exercise date").

merits. As explained in Section B above, the fixed price exercise of the Put did not lead to a "sale" under the SEC's regulations. *See* 17 C.F.R. § 240.16b-6(b). Moreover, the SEC itself has twice rejected the dual sale approach the Bondholders now propose: first in its 1991 regulations, which treat a fixed price exercise as a non-event (i.e., Rules 16b-6(a) and (b)), and second in its *Amicus* Brief to the Second Circuit that concluded that the March 2000 Put can only be recognized as a sale on its March 28, 2000 establishment date (Cox App. 13a-14a).[22]

Third, the Bondholders are flatly wrong in asserting that the March 2000 Put should be treated as a sale on its exercise date because supposedly "the risk of speculative abuse with respect to the Put . . . dramatically increased" over time. Pet. at 11. As the Second Circuit and SEC found (and as demonstrated above in Section B), for options with fixed price components (such as the Put), "the greatest risk of short-swing profiteering arises at the point in time nearest the establishment of the option," at which time corporate insiders with non-public information can use the hybrids to lock-in guaranteed profits. *See* Pet. App. 7a. This *locked-in* profit is not dependent upon the passage of time, but rather exists regardless of the option's exercise date.

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[22] The Bondholders' "dual sale" approach to the *fixed* price exercise of the March 2000 Put must be distinguished from the issue of a two-step profit calculation for a hybrid exercised at a *floating* price (an issue not present here). As noted above, the Bondholders' "dual sale" approach, which would treat both the establishment and exercise of the fixed price component of a hybrid put as a Section 16(b) sale, violates Rule 16b-6(b). That rule mandates that the "the closing of a derivative security position as a result of its exercise . . . shall be exempt from the operation of" Section 16(b). 17 C.F.R. § 240.16b-6(b). On the other hand, the SEC rules do not forbid a two-step profit calculation for the exercise of a hybrid's floating component, and in addition to the District Court in this case, at least one other court has suggested that a two-step approach may be applied in such circumstances. *See Schaffer*, 280 F. Supp. 2d at 140.

The Bondholders ignore this locked-in profit and instead present a complicated Rube Goldberg scenario that purportedly demonstrates this "increased potential for speculative abuse." Specifically, the Bondholders posit that an insider might: (1) enter into a hybrid put at a $48 fixed price or a floating market price; (2) wait ten months for the put to be exercisable under its terms; (3) receive information that a company will (a) announce news that will make its stock price drop to $24 a share, *and then* (b) announce additional news that will make its stock price rise above $24 a share; (4) exercise the put at the $48 per share price after the release of the bad information; (5) buy back the stock sold through the put at a lower market price; and (6) benefit from an increase in the price of stock from the anticipated appreciation of the stock. *See* Pet. at 11.

In fact, this hypothetical does not demonstrate any increased potential for speculative abuse between the Put's establishment and its exercise. Rather, the SEC regulations that dictate how derivatives are treated reflect the SEC's careful balancing of the risks posed by these instruments. Because the hybrid put in the example is exercised at its fixed price, and its floating component *never* comes into play, an insider could accomplish the same effect as in the scenario above through a *purely fixed price put.* By design, as explained above in Section B, SEC Rules 16b-6(a) and (b) treat the establishment of such a fixed price put as a sale and its exercise as a non-event. *See* 17 C.F.R. § 240.16b-6(a) & (b). Because a hybrid put exercised at its fixed price presents the *same* potential for abuse as a purely fixed price put, it makes perfect sense that such a hybrid should be treated the same way as a purely fixed price put.[23]

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[23] In addition, this convoluted scenario would not allow an insider to circumvent Section 16(b). Section 16(b) by design only covers "short swing" profits, i.e. those obtained from a matching purchase and sale within a period of less than six months. Because the establishment of a

Fourth, the Bondholders' assertion that the March 2000 Put should be treated as a sale in 2001 because its hybrid pricing mechanism purportedly did not allow Cox to "hedg[e] and speculat[e]" until close to the Put's exercise date (Pet. at 10-11) is nonsensical and entirely misapprehends the purpose of Section 16(b). Section 16(b) is aimed at preventing insiders from making profits from the misuse of inside information regarding *known* future price movements. *See* 15 U.S.C. § 78p(b) (statute is "[f]or the purpose of preventing the unfair use of information which may have been obtained" by insiders); *Kern County Land Co. v. Occidental Petroleum Corp.*, 411 U.S. 582, 591 (1973) (prior to enactment of Section 16(b), "[i]nsiders could exploit information not generally available to others to secure quick profits").

Section 16(b) is not aimed at preventing insiders from hedging against *unknown* risks, or from protecting themselves from price swings that a stock price *might* take (i.e., situations where an insider has *no inside information*), as the Bondholders imply. Because any locked-in profit from inside information is known when a hybrid derivative (such as the Put) is established, SEC rules treat derivatives with fixed exercise prices as Section 16(b) events on the date of their establishment, and not later based on their alleged potential to "hedge" against unknown market developments. *See* 17 C.F.R. § 240.16b-6(a) & (b).

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fixed price put is equivalent to a simple sale, Rule 16b-6(a) treats that establishment as a sale. The Bondholders' hypothetical posits a 10 month waiting period from the establishment of the fixed price option (step one) until the alleged matching purchase (step five), and thus by definition does not involve a matching purchase and sale within a period of less than six months. Moreover, the profit from the difference between the reduced purchase price (in step five) and the anticipated higher price (in step six) would be captured by Section 16(b) if the insider realized that profit by selling at the higher price within six months of the purchase.

Finally, the Bondholders' contention that the Second Circuit employed a "hindsight" approach when it held that the March 2000 Put was a sale as of March 28, 2000 (Pet. at 12) is wholly misguided.[24] In fact, the Second Circuit applied Rule 16b-6(a) to the establishment of the Put (to conclude that it was a sale), and separately applied Rule 16b-6(b) to the subsequent fixed price exercise of the Put (to conclude that it was an exempt non-event under Section 16(b)). *See* Pet. App. 8a. No "hindsight" at all was involved in this analysis. The Second Circuit *did not hold* that the March 2000 Put only *became* a sale in March 2000 when it was exercised at a fixed price in January 2001 (as the Bondholders suggest). Rather, it concluded that it was a sale on the date of its establishment because that is when the profit opportunity was locked-in.

CONCLUSION

WHEREFORE, respondents Cox Communications, Inc. and Cox @Home, Inc. respectfully request that the Bondholders' petition for a writ of *certiorari* be denied.

Respectfully submitted,

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[24] The Second Circuit's holding is also correct for a number of independent reasons not reached by the Second Circuit's opinion. Among other things, there was no matching Section 16(b) "purchase" of At Home stock and no purchase or sale of At Home securities would be cognizable under the unorthodox transaction doctrine. *See* Cox Appellate Brief at 45-55.

APPENDIX

APPENDIX A

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

No. 05-0115-CV

AT HOME CORPORATION,
Plaintiff-Appellant,

v.

COX COMMUNICATIONS, INC., COX@HOME, INC.,
COMCAST CORPORATION, COMCAST ONLINE
COMMUNICATIONS, INC., COMCAST PC INVESTMENTS, INC.,
BRIAN L. ROBERTS AND DAVID M. WOODROW,
Defendants-Appellees.

On Appeal from the United States District Court
for the Southern District of New York

BRIEF OF THE SECURITIES AND
EXCHANGE COMMISSION, *AMICUS CURIAE*,
SUBMITTED AT THE REQUEST OF THE COURT

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TABLE OF CONTENTS

Page

TABLE OF AUTHORITIES iii

INTRODUCTION 1

BACKGROUND 2

ARGUMENT 4

I. THE ESTABLISHMENT OF THE PUTS IN MARCH 2000 CONSTITUTED A SALE OF AT HOME STOCK FOR PURPOSES OF SECTION 16(b) 4

II. THE MAY 2001 AGREEMENT TO CANCEL THE FIXED PRICE PUTS WAS A PURCHASE FOR SECTION 16(b) PURPOSES 9

III. COMCAST'S ACQUISITION OF THREE CABLE COMPANIES THAT OWNED AT HOME WARRANTS WAS NOT A PURCHASE OF THE WARRANTS FOR PURPOSES OF SECTION 16(b) 10

IV. THE "UNORTHODOX TRANSACTION DOCTRINE" IS INAPPLICABLE TO THE TRANSACTIONS IN THIS CASE 15

V. CONTROLLING DEFERENCE IS OWED BY THE COURT TO THE COMMISSION'S REASONABLE INTERPRETATIONS OF SECTION 16(b) AND RELATED COMMISSION RULES 16

A. This Court and the Supreme Court Have Repeatedly Held that a Court Is Bound by an Agency's Reasonable Interpretations of Its Own Regulations Provided in an *Amicus* Brief 16

TABLE OF CONTENTS—Continued

Page

B. This Court Should Accord *Chevron* Deference to Interpretations of the Federal Securities Statutes Provided in Commission *Amicus* Briefs 18

CONCLUSION 27

CERTIFICATE OF COMPLIANCE WITH F.R.A.P. 32(A)

CERTIFICATE OF COMPLIANCE WITH LOCAL RULE 32(a)(1): BRIEFS IN DIGITAL FORMAT

CERTIFICATE OF SERVICE

TABLE OF AUTHORITIES

CASES **Page**

Alaska Dept. of Environmental Conservation v. EPA, 540 U.S. 461 (2004) 22
American Standard, Inc. v. Crane Co., 510 F.2d 1043 (2d Cir. 1974) 12
At Home Corporation v. Cox Communications, et al., 340 F. Supp. 2d 404 (S.D.N.Y. 2004) 2
Auer v. Robbins, 519 U.S. 452 (1997) 17, 18
Barnhart v. Walton, 535 U.S. 212 (2002) 17, 21, 23
Bowen v. Georgetown Univ. Hospital, 488 U.S. 204 (1988) 17
Bowles v. Seminole Rock & Sand Co., 325 U.S. 410 (1945) 17, 18
Chevron, U.S.A., Inc. v. Natural Resources Defense Council, Inc., 467 U.S. 837 (1984) ..... 18, 19, 20, *passim*
Christensen v. Harris County, 529 U.S. 576 (2000) 20, 22
Community Health Center v. Wilson-Coker, 311 F.3d 132 (2d Cir. 2002) 23
Dabit v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 395 F.3d 25 (2d Cir.), *cert. granted*, 126 S. Ct. 34 (2005) 20, 23
DeMaria v. Andersen, 318 F.3d 170 (2d Cir. 2003) 17
Drake v. FAA, 291 F.3d 59 (D.C. Cir. 2002) 18
Ecarnacion v. Barnhart, 331 F.3d 78 (2d Cir. 2003) 18
In re Enterprise Mortgage Acceptance Co., LLC, Securities Litigation, 391 F.3d 401 (2d Cir. 2005) 20, 23
Foremost-McKesson, Inc. v. Provident Securities Co., 423 U.S. 232 (1976) 13
Gollust v. Mendell, 501 U.S. 115 (1991) 13

TABLE OF AUTHORITIES—Continued

Page

Gryl v. Shire Pharmaceuticals Group PLC., 298 F.3d 136 (2d Cir. 2002) 25
Kern County Land Co. v. Occidental Petroleum Corp., 411 U.S. 582 (1973) ..... 11, 12, 14, *passim*
LaFleur v. Whitman, 300 F.3d 256 (2d Cir. 2002) 18
Levy v. Southbrook International Investments, Ltd., 263 F.3d 10 (2d Cir. 2001) 17, 25
Martin v. Occupational Safety & Health Rev. Com'n., 499 U.S. 144 (1991) 18
National Cable & Telecommunications Assoc. v. Brand X Internet Services, __ U.S. __, 125 S. Ct. 2688 (2005) 19
In re New Times Securities Services, Inc., 371 F.3d 68 (2d Cir. 2004) 24, 26
Press v. Quick & Reilly, Inc., 218 F.3d 121 (2d Cir. 2000) 17
Reliance Electric Co. v. Emerson Electric Co., 404 U.S. 418 (1972) 12, 13
SEC v. American Board of Trade, Inc., 751 F.2d 529 (2d Cir. 1984) 14
Skidmore v. Swift & Co., 323 U.S. 134 (1944) 19
Taylor v. Vt. Dep. of Educ., 313 F.3d 768 (2d Cir. 2002) 18
United States v. Mead Corp., 533 U.S. 218 (2001) 20, 22
Washington State Dept. of Social and Health Servs. v. Guardianship Estate of Keffeler, 537 U.S. 371 (2003) 22
Yoder v. Orthomolecular Nutrition Institute, Inc., 751 F.2d 555 (2d. Cir. 1985) 14
Yourman v. Giuliani, 229 F.3d 124 (2d Cir. 2000) 17

TABLE OF AUTHORITIES—Continued

COMMISSION RELEASES **Page**

Notice of Proposal to Adopt a Rule Exempting from the Operation of Section 16(b) Certain Acquisitions and Dispositions of Securities Pursuant to Mergers or Consolidations, Exchange Act Rel. No. 4696, 17 Fed. Reg. 3177, 1952 SEC LEXIS 63 (April 9, 1952) 13

Ownership Reports and Trading By Officers, Directors and Principal Securities Holders, Exchange Act Rel. No. 28869, 56 Fed. Reg. 7242 (Feb. 21, 1991) 4, 5, 18

STATUTES AND RULES

Securities Exchange Act of 1934, 15 U.S.C. 78a, *et seq.*

Section 3(a), 15 U.S.C. 78c(a) 15

Section 3(a)(10), 15 U.S.C. 78c(a)(10) 14

Section 3(a)(13), 15 U.S.C. 78c(a)(13) 10, 14

Section 16(b), 15 U.S.C. 78p(b) ..... 1, 2, 3, *passim*

Rules Under the Securities Exchange Act of 1934, 17 C.F.R. 240.01, *et seq.*

Rule 16a-1(c), 17 C.F.R. 240.16a-1(c) 5

Rule 16a-1(c) (6), 17 C.F.R. 240.16a-1(c) (6) 7

Rule 16a-1(h), 17 C.F.R. 240.16a-1(h) 5

Rule 16a-9, 17 C.F.R. 240.16a-9 25

Rule 16a-10, 17 C.F.R. 240.16a-10 25

Rule 16a-11, 17 C.F.R. 240.16a-11 25

Rule 16a-12, 17 C.F.R. 240.16a-12 25

Rule 16a-13, 17 C.F.R. 240.16a-13 25

Rule 16b-1, 17 C.F.R. 240.16b-1 25

Rule 16b-2, 17 C.F.R. 240.16b-2 25

Rule 16b-3, 17 C.F.R. 240.16b-3 25

Rule 16b-4, 17 C.F.R. 240.16b-4 25

Rule 16b-5, 17 C.F.R. 240.16b-5 25

TABLE OF AUTHORITIES—Continued

STATUTES AND RULES (Continued) **Page**

Rule 16b-6, 17 C.F.R. 240.16b-6 25
Rule 16b-6(a), 17 C.F.R. 240.61b-6(a) 5, 9
Rule 16b-6(b), 17 C.F.R. 240.61b-6(b) 6
Rule 16b-6(d), 17 C.F.R. 240.16b-6(d) 8, 9
Rule 16b-7, 17 C.F.R. 240.16b-7 25
Rule 16b-8, 17 C.F.R. 240.16b-8 25

MISCELLANEOUS

David S. Ruder, Address: The Development of Legal Doctrine Through Amicus Participation: The SEC Experience, 1989 Wis. L. Rev. 1167 (1989) 26
H.R. Rep. No. 1383, 73d Cong., 2d Sess. 13 (1934) 13
Request for Commission Amicus Participation in a Pending Case, http://www.sec.gov/litigation/briefs/amicusrequest.htm 26

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

No. 05-0115-cv

AT HOME CORPORATION,
Plaintiff-Appellant,

v.

COX COMMUNICATIONS, INC., COX@HOME, INC., COMCAST CORPORATION, COMCAST ONLINE COMMUNICATIONS, INC., COMCAST PC INVESTMENTS, INC., BRIAN L. ROBERTS AND DAVID M. WOODROW,
Defendants-Appellees.

On Appeal from the United States District Court
for the Southern District of New York

BRIEF OF THE SECURITIES AND EXCHANGE COMMISSION, *AMICUS CURIAE*, SUBMITTED AT THE REQUEST OF THE COURT

INTRODUCTION

The Securities and Exchange Commission submits this brief as *amicus curiae* in response to a request by the Court.

This action was brought by At Home Corporation ("At Home," "issuer," or "plaintiff") under Section 16(b) of the Securities Exchange Act of 1934, 15 U.S.C. 78p(b), to recover alleged short-swing profits obtained by insiders of At Home. The complaint alleges that defendants—Cox Communications, Inc., Comcast Corporation and their affiliates—sold and then purchased, or purchased and sold, At Home

equity securities within six months. The defendants are alleged to have acted as a group that owned more than 10 percent of At Home securities, and thus to be statutory insiders of At Home. The suit seeks recovery of profits the defendants allegedly realized on these short-swing trades. The district court dismissed plaintiff's Section 16(b) claims. *See At Home Corporation v. Cox Communications, et al.*, 340 F. Supp. 2d 404 (S.D.N.Y. 2004). The Commission agrees with the district court that defendants are not liable under Section 16(b).

BACKGROUND

At Home was founded by a number of cable companies in March 1995 to provide cable-based internet access to customers (Compl. ¶18). On March 28, 2000, the defendants, Cox and Comcast, entered into a letter agreement with AT&T ("agreement") in which Cox and Comcast acquired, respectively, a put to sell to AT&T up to $1.4 billion and $1.5 billion in At Home shares. Under the terms of the agreement, Cox and Comcast could sell each share for the higher of (1) $48 or (2) a floating average market price at the time of exercise (A-133; Compl. ¶45).

Defendants notified AT&T of their intention to exercise their puts on January 11, 2001. At that time, At Home's shares were selling for an average $7.72 per share (Compl. ¶53). Accordingly, defendants' notices to AT&T stated that the defendants "assumed" that the purchase price would be $48 per share (A-165, 168). AT&T did not want the shares. AT&T and the defendants entered into a new agreement on May 18, 2001 whereby the defendants canceled their puts in exchange for 155.3 million shares of AT&T stock worth $3.43 billion (Compl. ¶56).

The plaintiff alleged that Cox and Comcast sold At Home shares for purposes of Section 16(b) on January 11, 2001, when they provided notice of their intent to exercise the

puts.[1] This was within six months of the May 18, 2001 agreement to rescind the puts, which plaintiff contended was a purchase of At Home securities. The district court agreed that the rescission was a purchase, but held that the earlier sale occurred on March 28, 2000, when the puts were established, so that the sale and purchase took place more than six months apart, and were thus not subject to Section 16(b).

The plaintiff alternatively claimed that if the sale occurred on March 28, 2000, Comcast made matching purchases when, between January and August 2000, it acquired three cable companies that held At Home securities. The district court dismissed this claim, holding that these indirect acquisitions were not cognizable transactions under Section 16(b).

The plaintiff appealed, and this Court has sent a letter to the Commission inviting it to answer five questions. We address those questions in order.

ARGUMENT

I. THE ESTABLISHMENT OF THE PUTS IN MARCH 2000 CONSTITUTED A SALE OF AT HOME STOCK FOR PURPOSES OF SECTION 16(b).

The Court asks "[w]hether the establishment of the puts on March 28, 2000 constituted a sale of At Home securities for purposes of section 16(b) * * *." It did. Before 1991, the purchase or sale of securities underlying a derivative security occurred on the exercise of the derivative, rather than upon its creation. In 1991, the Commission noted that this left "open a significant potential for short-swing abuse in trading derivative securities." *Ownership Reports and Trading By*

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[1] Alternatively, the plaintiffs contended that the sales occurred on February 2, 2001, at the end of the 30 day period for determining if the fixed rate or the floating rate was higher.

Officers, Directors and Principal Securities Holders, Exchange Act Rel. No. 28869, 56 Fed. Reg. 7242, 7250 (Feb. 21, 1991). In that release, the Commission offered the following example:

> [A]n insider with knowledge of a positive material development, to be announced shortly, determines that while he wants to retain his existing equity position, he wants to take advantage of the information, so he purchases issuer warrants. After the public announcement and rise in the stock price the insider sells his common stock, obtaining a short-swing profit, knowing that he can replace the shares at a predetermined price since he holds the warrants. Under the former rules, he could simply wait six months and a day to exercise the warrants so the profit would not be subject to section 16(b) and not recoverable by the company.

Id. at 7250. Likewise, an insider who knows of impending negative information can negotiate a fixed price put, enabling it to sell, after the negative information is released and the price falls, at the higher price. The insider unfairly uses the inside information by fixing the price when the derivative is created, not when it is exercised.

In 1991, the Commission amended the rules so that the acquisition of a "derivative security" is also considered the acquisition of the underlying securities for purposes of Section 16(b). "[D]erivative security" was defined to mean "any option, warrant, convertible security, stock appreciation right, or similar right with an exercise or conversion privilege at a price related to an equity security, or similar securities with a value derived from the value of an equity security * * *." Rule 16a-1(c), 17 C.F.R. 240.16a-1(c). Rule 16b-6(a), 17 C.F.R. 240.16b-6(a), provides:

> The * * * establishment of or increase in a put equivalent position or liquidation of or decrease in a

> call equivalent position shall be deemed a sale of the underlying securities for purposes of section 16(b) of the Act * * *.

A "put equivalent position" is defined by Rule 16a-1(h), 17 C.F.R. 240.16a-1(h), to mean "a derivative security position that increases in value as the value of the underlying equity decreases, including, but not limited to, a long put option and a short call option position." A put with a fixed exercise price increases in value as the price of the underlying stock decreases because the spread between the market price and the fixed exercise price increases.

On the other hand, a floating price linked to the market price does not have that attribute. The 1991 rules draw a sharp distinction between fixed and floating prices. The Commission explained that "[r]ights without a fixed exercise price do not provide an insider the same kind of opportunity for short-swing profit since the purchase price is not known in advance." *Ownership Reports*, Exchange Act Rel. No. 28869, 56 Fed. Reg. at 7252. The Commission stressed that "[t]he opportunity to lock in a profit begins when the exercise price is fixed; at that time, the right becomes a derivative security subject to section 16." *Id.* Conversely, the later *exercise* of a derivative at its *previously* fixed price is exempt from Section 16(b) and has no Section 16(b) consequences. *See* Rule 16b-6(b), 17 C.F.R. 240.16b-6(b).

On the other hand, the Commission explained that:

> [A] right with a floating exercise price is not required to be reported and will not be deemed to be acquired or purchased, for section 16 purposes, until the purchase price of the underlying security becomes fixed or established, which commonly occurs at exercise. Thus, a right to purchase an equity security is deemed acquired as of the date the exercise or conversion price becomes fixed, and the acquisition, absent an exemption, would be

> matchable for section 16(b) purposes with a disposition within six months of the fixing of the price.

56 Fed. Reg. at 7253. "The primary potential for abuse [of inside information] arises at the time of exercise for a floating price derivative security because only at exercise is the price fixed and, therefore, the extent of the profit opportunity defined." Thus, "[b]y treating the exercise of the floating price derivative security as the 'acquisition' of the underlying security, the rules mitigate the incentives for insiders to abuse their informational advantage."[2]

In this case, the March 2000 agreement presented the defendants with puts with a fixed price of $48 paired with puts with a floating price based on a specified market average. In January 2001, with the market price far below $48, the defendants chose to exercise their puts at the fixed price. The opportunity to abuse inside information existed only at the time the fixed exercise price was set. If inside information is learned only after the fixed price is set, the information cannot be abused in later exercising at the fixed price. Because the fixed price was used in this case, the establishment of the puts is when the six month trading period should begin. The district court correctly concluded that the establishment of the puts in March 2000 constituted a sale of At Home stock under Section 16(b).

Plaintiff nevertheless argues that the hybrid security should be treated as a floating price derivative security, as though there were no fixed component. The cornerstone of plaintiff's contention is that, "in contrast to any other instrument in any other reported case of which we are aware, the **only** fixed component at issuance was not the number of shares or price per share, but the **total consideration** to be paid by the

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[2] This is reflected in Rule 16a-1(c)(6), 17 C.F.R. 240. 16a-1(c)(6), which excludes from the definition of a "derivative security" "[r]ights with an exercise or conversion privilege at a price that is not fixed."

grantor of the option (AT&T)." (Appellant's Brief p. 37 (emphases in original)). Thus, "[t]he only fact that all the parties to the Put knew on March 28, 2000 was that AT&T would pay a total of approximately $2.9 billion, but the number of shares and the price per share could not be known until after notice was given and the stock market determined the final price"(Appellant's Brief p. 37-38).

The district court correctly rejected this argument, pointing out that "[t]he specified maximum overall price of $2.9 million, when combined with the specified minimum per-share price of $48, dictated that defendants could sell, at most, 60.4 million shares.[3] Thus the initial agreement *did* limit the number of shares which AT&T would be required to buy." 340 F. Supp. 2d at 410 (emphasis in original).[4]

II. THE MAY 2001 AGREEMENT TO CANCEL THE FIXED PRICE PUTS WAS A PURCHASE FOR SECTION 16(b) PURPOSES.

The Court next asks whether the May 18, 2001 agreement—in which the defendants agreed not to exercise their puts—was a purchase for purposes of Section 16(b). The district court held that it was a purchase but that, since it occurred more than six months after the sale on March 28, 2000, the plaintiff's first claim should be dismissed. That is correct.

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[3] Since both the total and per share prices were fixed, the number of shares with respect to the fixed price component was fixed.

[4] Plaintiff also argues that the holding of the district court is unworkable in cases when the insider exercises a hybrid put at the floating rate because it would require there to be a second sale of the same underlying securities: "There could not be a 'second' sale, because according to the district court, **all** of the shares were deemed sold on March 28, 2000 at $48 per share * * *" (Appellant's Brief p. 37). This is incorrect. Where an insider exercises a hybrid put at the floating price, the fixed price put expires on an exempt basis by virtue of Rule 16b-6(d). The underlying shares become available for a different sale.

Under Rule 16b-6(a) the "liquidation of or decrease in a put equivalent position shall be deemed a purchase of the underlying security for purposes of section 16(b) * * *." The May 2001 agreement explicitly cancelled what had been the defendants' put equivalent position. Rule 16b-6(d), 17 C.F.R. 240.16b-6(d), provides that "[t]he disposition or closing of a long derivative security position, as a result of cancellation or expiration, shall be exempt from section 16(b) of the Act *where no value is received* from the cancellation or expiration" (emphasis added). This agreement does not qualify for that exemption since Cox and Comcast did receive value in exchange for agreeing to forgo the right to exercise their puts.

Defendants nonetheless contend that "[a]fter the March 2000 Put was exercised on January 11, 2002, *there was no put to 'cancel*'" and that the "[c]ourts uniformly have held that 'once an option is exercised, *the option itself ceases to exist* and an enforceable bilateral contract is formed.'" (Brief of Appellee Cox p. 45 (emphases in original); *see also* Brief of Appellee Comcast pp. 38-39). Defendants' argument places semantics over substance: while the defendants gave notice of their intent to exercise the puts, they never, in fact, followed through and transferred any shares to AT&T.

III. COMCAST'S ACQUISITION OF THREE CABLE COMPANIES THAT OWNED AT HOME WARRANTS WAS NOT A PURCHASE OF THE WARRANTS FOR PURPOSES OF SECTION 16(b).

This Court's third question is "[w]hether Comcast's acquisition of three cable companies that owned warrants to purchase shares of At Home stock in January, March and August 2000 should be characterized as a § 16(b) purchase of At Home securities." Under Count II of their complaint, plaintiff urges that if, *arguendo*, as Comcast contends, the creation of the put in March 28, 2000 constituted a 'sale' for purposes of Section 16(b), then that sale can be matched with

Comcast's acquisition of the warrants, which took place within six months of March 28, 2000 (Appellant's Brief pp. 44-46; *See also* Compl. ¶ 74).[5] The plaintiff argues that "purchase," as defined by Section 3(a)(13) of the Exchange Act, 15 U.S.C. 78c(a)(13), includes "any contract to buy, purchase, or otherwise acquire" and that this definition is broad enough to include the purchase of another company that, in turn, owns securities of the issuer (Appellant's Brief pp. 44-46).

The district court held that these transactions are not within the scope of Section 16(b) because the acquisition of the warrants was an incidental part of acquisitions of the three companies. Without deciding whether this amounted to a "purchase" of securities for purposes of Section 16(b), the court held (340 F. Supp. 2d at 411):

> 'In deciding whether borderline transactions are within the reach of the statute, the courts have come to inquire whether the transaction may serve as a vehicle for the evil which Congress sought to prevent—the realization of short-swing profits based upon access to inside information.' *Kern County Land Co. v. Occidental Petroleum Corp.*, 411 U.S. 582, 594 [ ] (1973). We can conceive of situations where an insider could acquire one company simply (or mainly) to obtain its interests in the subject company, as when the acquired company has few other assets or exists for the sole purpose of trading in shares of the subject company. However, plaintiff has failed to plead any facts giving rise to such a possibility here.

The district court was correct to find that this sort of indirect acquisition in a change-in-control transaction typically does not fall within the scope of Section 16(b). The

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[5] There are no allegations against Cox in Count II.

district court, however, incorrectly resolved the issue by use of *Kern*. The *Kern* Court held that a transaction that literally falls within the scope of Section 16(b) may, nevertheless, be excluded from the section if, on the facts of the case, it does not present a risk of speculative abuse. While the defendant in *Kern* was a greater than 10% owner of stock in the issuer, it also was an unsuccessful hostile tender offeror. To the Court, the critical factors in excluding the defendant from liability under Section 16(b) were that the defendant was forced to sell pursuant to a merger agreement, whose terms it did not negotiate, and, as a hostile tender offeror, the defendant did not have access to inside information. *See Kern*, 411 U.S. at 597-98. This Court has read *Kern* to require that the insider not have access to inside information and/or have no control over the terms of the transaction or its occurrence. *See American Standard, Inc. v. Crane Co.*, 510 F.2d 1043, 1054 (2d Cir. 1974). Here, defendant Comcast does not meet either of those criteria, and we believe *Kern* does not apply.

This case calls for a different approach. The acquisition of At Home warrants here was an indirect consequence of a change-in-control transaction. In general (although there can be exceptions, as we discuss below), this sort of indirect and incidental acquisition should be presumed not to be a "purchase" for purposes of Section 16(b), since it is not the sort of transaction Congress was concerned about. The Supreme Court has stated that "'the only method Congress deemed effective to curb the evils of insider trading was a flat rule taking the profits out of a class of transactions in which the possibility of abuse was believed to be intolerably great.'" *Kern*, 411 U.S. at 592 (*quoting Reliance Electric Co. v. Emerson Electric Co.*, 404 U.S. 418, 422 (1972)). As the Commission explained long ago, a six-month period was chosen because that "arbitrary period" was thought "as roughly marking the distinction between short swing speculation and long term investment." *Notice of Proposal to Adopt a Rule Exempting from the Operation of Section 16(b)*

Certain Acquisitions and Dispositions of Securities Pursuant to Mergers or Consolidations, Exchange Act Rel. No. 4696, 17 Fed. Reg. 3177, 1952 SEC LEXIS 63 (April 9, 1952).

Because Section 16(b) can be harsh in imposing strict liability, "Congress itself limited carefully the liability imposed by §16(b)." *Foremost-McKesson, Inc. v. Provident Securities Co.*, 423 U.S. 232, 252 (1976).[6] "When Congress has so recognized the need to limit carefully the 'arbitrary and sweeping coverage' of §16(b) * * * courts should not be quick to determine that * * * Congress intended the section to cover a particular transaction." *Id.* at 252 (citations omitted). *See also Gollust v. Mendell*, 501 U.S. 115, 122 (1991); H.R. Rep. No. 1383, 73d Cong., 2d Sess. 13 (1934).

An insider who seeks to profit from inside information typically will engage in a purchase or sale in the issuer's securities, and then engage in an opposite-way transaction when the information becomes public, and the securities' price is affected. A change in control, however, is typically motivated by a desire to acquire control of a company. It also involves complex negotiations, and many strategic corporate considerations, and often involves regulatory review and approval. While it is not beyond possibility that an acquiror would tailor a change in control transaction to obtain short-swing profits from insider trading, it is certainly not going to be a common scenario. Good faith change in control transactions are not ones "in which the possibility of abuse [is] intolerably great," *Kern*, 411 U.S. at 592.

The plaintiff nonetheless argues that these acquisitions literally meet the words of the definition of "purchase" in Section 3(a)(13) of the Exchange Act. However, the prefatory language to the Exchange Act definitions states that they apply "[w]hen used in this title, unless the *context otherwise*

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[6] *See also Gollust v. Mendell*, 501 U.S. 115, 122 (1991); *Reliance Electric Co. v. Emerson Electric Co.*, 404 U.S. at 422-25.

requires." Section 3(a), 15 U.S.C. 78c(a) (emphasis added). This Court has "recognized the importance of this introductory phrase in certain situations." *Yoder v. Orthomolecular Nutrition Institute, Inc.*, 751 F.2d 555, 559 (2d. Cir. 1985). For example, Section 3(a)(10) of the Exchange Act, 15 U.S.C. 78c(a)(10), excludes from the definition of "security" "any note * * * which has a maturity at the time of issuance of not exceeding nine months, exclusive of days of grace, or any renewal thereof the maturity of which is likewise limited." In spite of this language, which would seem to exempt all notes of any quality, so long as of proper duration, this Court has long held, citing the context clause, that the exemption does not apply "literally," but only applies to notes that are the equivalent of commercial paper. *See, e.g., SEC v. American Board of Trade, Inc.*, 751 F.2d 529, 538 (2d Cir. 1984) (Friendly, J.).

Employment of the context clause is likewise appropriate here. As discussed above, Section 16(b) is a strict liability statute. The purpose of the provision must be taken into account when construing the Section 3(a) definitions of "purchase" and "sale" with respect to Section 16(b). Since a change in control transaction will rarely be used to engage in insider trading in securities held as an asset by the acquired company, this sort of indirect acquisition should presumptively be deemed not to be a purchase for purposes of Section 16(b) (or a sale by the prior owners of the company). We say "presumptively" because, as the district court noted, there may be circumstances where an insider uses the acquisition of another entity as a subterfuge in order to acquire underlying securities. The plaintiff, however, should bear the burden of pleading and proving that this indirect acquisition was such an exception, something the plaintiff has not done here.[7]

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[7] This does not mean, as might be thought, that Section 16(b) would cease to be a strict liability statute. It is a strict liability statute with respect to short-term transactions that are properly deemed purchases and sales

IV. THE "UNORTHODOX TRANSACTION DOCTRINE" IS INAPPLICABLE TO THE TRANSACTIONS IN THIS CASE.

This Court next asks "[w]hether the *Kern* 'unorthodox transaction' doctrine supports the District Court's dismissal of either of the relevant claims." As discussed in the prior section, we do not believe that the doctrine should be expanded to apply, as the district court did, to the claim based on indirect acquisition of At Home warrants in three change of control transactions.

Separately, Cox argues that dismissal of plaintiff's *first* cause of action should be affirmed because "[a]s in *Kern County*, AT&T 'undoubtedly knew more about' At Home than Cox at the time of the alleged 'purchase' and 'sale'" (Brief of Appellee Cox pp. 54-55, *citing Kern County*, 411 U.S. at 602). While this might be true, it is not a basis for applying *Kern*, which this Court has read to require lack of access to inside information and/or a forced transaction, neither of which existed here.

V. CONTROLLING DEFERENCE IS OWED BY THE COURT TO THE COMMISSION'S REASONABLE INTERPRETATIONS OF SECTION 16(b) AND RELATED COMMISSION RULES.

The Court asks "[w]hat deference, if any, this Court owes the positions the SEC adopts in its *amicus curiae* brief." This actually presents two questions: (1) what deference is owed to the Commission's construction of its own rules in an *amicus* brief; and (2) what deference is owed to the Commission's construction of the federal securities statutes provided in an *amicus* brief.

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for purposes of the statute. The inquiry here is whether a purchase was involved.

A. This Court and the Supreme Court Have Repeatedly Held that a Court Is Bound by an Agency's Reasonable Interpretations of Its Own Regulations Provided in an *Amicus* Brief.

The deference accorded by the courts to the Commission's interpretations of its own rules in an *amicus* brief is settled law. This Court has repeatedly held that it is "'bound by the SEC's interpretations of its regulations in its *amicus* brief, unless they are 'plainly erroneous or inconsistent with the regulation[s].'" *DeMaria v. Andersen*, 318 F.3d 170, 175 (2d Cir. 2003) and *Levy v Southbrook International Investments, Ltd.*, 263 F.3d 10, 14 (2d Cir. 2001) (*both cases quoting Press v. Quick & Reilly, Inc.*, 218 F.3d 121, 128 (2d Cir. 2000)). *Accord Yourman v. Giuliani*, 229 F.3d 124, 128 (2d Cir. 2000) (deferring to an interpretation of regulations submitted in an *amicus* brief by the Secretary of Labor). In *Bowles v. Seminole Rock & Sand Co.*, 325 U.S. 410, 414 (1945), the Supreme Court first established the principle that an agency's interpretation of one of its own regulations commands substantial judicial deference such that the agency's interpretation "becomes of controlling weight unless it is plainly erroneous or inconsistent with the regulation."

More recently, the principle was reinforced in *Auer v. Robbins*, 519 U.S. 452 (1997), where petitioner complained that an agency's interpretation of a regulation came in the form of an *amicus* brief. The Supreme Court declared, "[t]hat does not, in the circumstances of this case, make it any less worthy of deference" because the agency's "position is in no sense a '*post hoc* rationalizatio[n]' advanced by [the] agency seeking to defend past agency action against attack" 519 U.S. at 462 (*quoting Bowen v. Georgetown Univ. Hospital*, 488 U.S. 204, 212 (1988)). "There is simply no reason to suspect that the interpretation does not reflect the agency's fair and considered judgment on the matter in question." *Id. See also*

Barnhart v. Walton, 535 U.S. 212, 217 (2002) (reaffirming *Auer*). As this Court has explained:

> [W]e recognized that an agency's interpretation of its own regulations is entitled to considerable deference, irrespective of the formality of the procedures used in formulating the interpretations. *See Taylor v. Vt. Dep. of Educ.*, 313 F.3d 768, 779-80 (2d Cir. 2002) (*citing Auer v. Robbins* [,*supra*, at 461]); *LaFleur v. Whitman*, 300 F.3d 256, 277 (2d Cir. 2002)). We defer to an agency's interpretation of its own regulations because we 'presume that the power authoritatively to interpret [the agency's] own regulations is a component of the agency's delegated lawmaking powers.' *Martin v. Occupational Safety & Health Rev. Com'n.*, 499 U.S. 144, 151 [] (1991).

Ecarnacion v. Barnhart, 331 F.3d 78, 86 (2d Cir. 2003).[8] In light of the well established law in the Supreme Court and this Court, the Commission's interpretations of its rules expressed in this brief are binding, unless they are plainly erroneous or inconsistent with the regulations.

B. This Court Should Accord *Chevron* Deference to Interpretations of the Federal Securities Statutes Provided in Commission *Amicus* Briefs.

The Court also owes controlling deference to the Commission's interpretation of the statute—Section 16(b)—provided in this *amicus* brief. The analysis of this question

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[8] There are three preconditions for applying *Bowles or Auer* deference: the language of the regulation in question must be ambiguous; there must be no reason to suspect that the interpretation does not reflect the agency's fair and considered judgment on the matter in question; and the agency's reading of its regulation must be fairly supported by the text of the regulation itself. *Drake v. FAA*, 291 F.3d 59, 68 (D.C. Cir. 2002) (citations omitted).

begins with *Chevron, U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984). As the Supreme Court has recently summarized:

> In *Chevron*, this Court held that ambiguities in statutes within an agency's jurisdiction to administer are delegations of authority to the agency to fill the statutory gap in reasonable fashion. Filling these gaps, the Court explained, involves difficult policy choices that agencies are better equipped to make than courts. 467 U.S., at 865-866, 81 L. Ed. 2d 694, 104 S. Ct. 2778. If a statute is ambiguous, and if the implementing agency's construction is reasonable, *Chevron* requires a federal court to accept the agency's construction of the statute, even if the agency's reading differs from what the court believes is the best statutory interpretation. *Id.* at 843-844, and n. 11, 104 S. Ct. 2778.

National Cable & Telecommunications Assoc., v. Brand X Internet Services, __ U.S. __, 125 S.Ct. 2688, 2699 (2005).[9]

For an agency interpretation to receive *Chevron* deference, the agency must have been entrusted by Congress with authority to interpret the statute, the statute must be ambiguous and subject to interpretation, and the agency's interpretation must be a reasonable one. The term "purchase" as applied to Section 16(b) is ambiguous. Congress has entrusted the Commission with responsibility for resolving ambiguities in light of the purpose of the statute. Section 16(b) provides that "[t]his subsection shall not be construed

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[9] Prior to *Chevron*, the Court held in *Skidmore v. Swift & Co.*, 323 U.S. 134 (1944), that the "rulings, interpretations and opinions of" an agency that do not constitute an exercise of lawmaking authority, "while not controlling upon the courts by reason of their authority, do constitute a body of experience and informed judgment" which are "entitled to respect" to the extent they are persuasive. *Id.* at 140.

to cover * * * any transaction or transactions which the Commission by rules and regulations may exempt as not comprehended within the purpose of this subsection." As this shows, Congress did not believe Section 16(b) was self-explanatory and vested the Commission with authority to identify the purpose of the statute and identify transactions which do not contravene the section's purpose.[10]

The Commission has generally done that through rulemaking. However, rulemaking is not a prerequisite for the Commission's views to be accorded *Chevron* deference. While earlier cases focused on the formality of an agency decision, such as whether it was the product of notice and comment rulemaking or of an adjudication, *see Christensen v. Harris County*, 529 U.S. 576, 587 (2000), more recent cases have focused on whether the interpretation is the product of authoritative agency consideration. In *United States v. Mead Corp.*, 533 U.S. 218 (2001), the Court addressed the level of deference to be accorded to Customs Service tariff classifications contained in "letter rulings." The court held that "administrative implementation of a particular statutory provision qualifies for *Chevron* deference when it appears that Congress delegated authority to the agency generally to make rules carrying the force of law, and that the agency interpretation claiming deference was promulgated in the exercise

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[10] In two recent cases, this Court declined to give *Chevron* deference to Commission *amicus* briefs because the statutes at issue did not explicitly look to the Commission to fill in interstices in the statutes. *See Dabit v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 395 F.3d 25, 34 n.6 (2d Cir.), *cert. granted.*, 126 S. Ct. 34 (2005) (Mem.) (construing provision of Securities Litigation Uniform Standards Act preempting state law securities fraud actions); *In re Enterprise Mortgage Acceptance Co., LLC, Securities Litigation*, 391 F.3d 401, 410 n.8 (2d Cir. 2005) (construing provision in Sarbanes-Oxley Act modifying statutes of limitation in private securities lawsuits). Whatever the merit of those decisions as to those statutes, this case involves a statute, Section 16(b), in which Congress expressly delegated to the Commission that responsibility.

of that authority." *Id.* at 226-27. While the Court noted that "the overwhelming number of our cases applying *Chevron* deference have reviewed the fruits of noticeand-comment rulemaking or formal adjudication," the Court added:

> That said, and as significant as notice-and-comment is in pointing to *Chevron* authority, the want of that procedure here does not decide the case, for we have sometimes found reasons for *Chevron* deference even when no such administrative formality was required and none was afforded.

Id. at 230-31. The Court held that "[t]he fact that the tariff classification here was not a product of such formal process does not alone, therefore, bar the application of *Chevron*," *Id.* at 231. The opinion, however, gives little conclusive guidance as to what must be shown, since the Court held that the authorities cited to it—letter rulings issued by 46 different scattered Customs offices—were obviously not authoritative agency positions. *See id.* 233.

The next year, however, in *Barnhart v. Walton*, 535 U.S. 212 (2002), the Court achieved some clarity by stating flatly that an agency interpretation may be entitled to *Chevron* deference even when it is neither the product of notice-and-comment rulemaking nor has the force of law. The major factor the Court looked to is the level of *careful consideration an agency has given the question. See* 535 U.S. at 222. In *Barnhart* the petitioner, whose application for benefits was denied by the Social Security Administration, asked the Court to disregard the agency's interpretation found in recently promulgated regulations. The Court noted that the interpretation in fact was a "long standing" one and "the fact the Agency previously reached its interpretation through means less formal than 'notice and comment' rulemaking * * * does not automatically deprive that interpretation of the judicial deference otherwise due" under *Chevron*. 535 U.S. at 221

(citations omitted). Then, turning its attention to the confusion caused by *Christensen* and *Mead*, the Court stated:

> If this Court's opinion in Christensen * * * suggested an absolute rule to the contrary, our later opinion in *United States v. Mead* * * * denied the suggestion. * * * Indeed, *Mead* pointed to instances in which the Court has applied *Chevron* deference to agency interpretations that did not emerge out of notice-and-comment rulemaking. * * * It indicated that whether a court should give such deference depends in significant part upon the interpretative method used and the nature of the question at issue.

535 U.S. at 221-222 (citations omitted).[11] The Court went on to conclude (*id.* at 222):

> In this case the interstitial nature of the legal question, the related expertise of the Agency, the importance of the question to administration of the statute, the complexity of that administration, and the careful consideration the Agency has given the question over a long period of time all indicate that *Chevron* provides the appropriate legal lens through which to view the legality of the Agency interpretation here at issue. * * *

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[11] As this makes clear, not every informal statement of agency position is to be accorded *Chevron* deference. The Supreme Court has since declined to accord such deference to internal agency guidance, such as that "presented in internal guidance memoranda," *Alaska Dept. of Environmental Conservation v. EPA*, 540 U.S. 461, 487 (2004), and an internal operating manual, *Washington State Dept. of Social and Health Servs. v. Guardianship Estate of Keffeler*, 537 U.S. 371, 385 (2003). We believe that the public position articulated here by the Commission itself, with the deliberative process undertaken to reach its position and the explanation of the reasons for that position, is more akin to the sort of articulations contained in rulemaking than it is to internal guidelines.

Later that year, this Court construed Barnhart to mean:

> Less formal interpretations may also be entitled to mandatory deference, depending upon to what extent the underlying statute suffers from exposed gaps in its policies, especially if the statute itself is very complex, as well as on the agency's expertise in making such policy decisions, the importance of the agency's decisions to the administration of the statute, and the degree of consideration the agency has given the relevant issues over time. *See Barnhart v. Walton*, 535 U.S. 212, 122 S. Ct. 1265, 1272, 152 L. Ed. 2d 330 (2002).

Community Health Center v. Wilson-Coker, 311 F.3d 132, 138 (2d Cir. 2002).[12]

The only statutory interpretation in this brief is whether Section 16(b) applies to a transaction where an insider acquires securities of an issuer indirectly by acquiring ownership of a third party company which, in turn, owns securities of the issuer. This is precisely the sort of question that Congress directed the Commission to deal with. Section 16(b) states that it will not apply to transactions which the Commission exempts as not within the purpose of the statute. Because the statute imposes strict liability, the Commission's role in determining when to exempt transactions is of critical importance to application of the statute. Congress and the Supreme Court have been clear that this is a statute which the Commission should assure is not unduly broad. This is, in short, precisely the sort of interstitial issue where *Chevron* deference is due the Commission's informal conclusions; "the

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[12] In *Dabit* and *Enterprise Mortgage*, this Court later cited *Mead* for the proposition that Commission views expressed in an *amicus* brief, rather than a rule or regulation, cannot receive *Chevron* deference. That position appears contrary to the Supreme Court's decision in *Barnhart* and this Court's decision in *Community Health Center*.

statute itself is very complex", the Commission has long and broad "expertise in making such policy decisions," and "the importance of the agency's decisions to the administration of the statute" is critical.

The only reason to consider not according conclusive deference to the Commission's position might be that it is not a "long-standing" one. That, however, is only true in the limited sense that the claim that the indirect acquisitions are within the scope of Section 16(b) is itself an apparently novel claim. The Commission should not have to envision every novel claim that might be made under Section 16(b) and analyze these hypothetical claims, before its views will be deemed authoritative.[13]

In a broader sense, moreover, the analysis here is closely similar to the sort of analysis the Commission has repeatedly engaged in for many years. The Commission has over the decades analyzed which transactions do not present risk within the purposes of Section 16(b).[14] Consistent with its rulemaking authority, the Commission has emphasized in both rules and *amicus* briefs that liability should exist only in situations where there is a real risk of insider trading.[15]

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[13] In *In re New Times Securities Services, Inc.*, 371 F.3d 68, 80-83 (2d Cir. 2004), this Court appeared to recognize that a Commission *amicus* brief might be entitled to Chevron deference, but declined to give it such deference because of the Commission's failure to previously address an issue even though it was longstanding. The Court also noted the presence of a competing view by an entity that administers the provision on a day to day basis, and the relation of the Commission to that entity. None of those facts exist in this case.

[14] *See, e.g., Rules* 16a-9 through 13 and 16b-1 through 16b-8, 17 C.F.R. 240.16a-9 to 16a-13 and 16b-1 to 16b-8.

[15] *See, e.g., Ownership Reports and Trading By Officers, Directors and Principal Securities Holders*, Exchange Act Rel. No. 28869, 56 Fed. Reg. 7242, 7252 (Feb. 21, 1991); *Brief of the Securities and Exchange Commission, Amicus Curiae, in Support of the Appellee on Issues Addressed*, at 23-24; *Levy v. Southbrook International Investments, Ltd*, 263 F.3d 10

The Commission's *amicus* position here satisfies the other requirements for *Chevron* deference. It is the product of careful consideration, and is the authoritative view of the Commission itself, not merely staff views. The Commission's Office of the General Counsel posted to the Commission's Web site a statement regarding consideration of *amicus* briefs. In relevant part, it states that after a request is made:

> The Office of the General Counsel will review the materials submitted and seek input from Divisions and Offices of the Commission that may have an interest in the case. In cases where further review is appropriate, the staff generally will contact both sides and offer them the opportunity to make further submissions in writing, in person, or by telephone. If the staff determines that *amicus* participation is merited in a particular case, the Office of the General Counsel will make a recommendation, together with interested Divisions and Offices, to the Commission. The Commission then considers and votes on whether to accept the recommendation and file a brief. This process can take a significant amount of time.

Request for Commission Amicus Participation in a Pending Case, posted at http://www.sec.gov/litigation/briefs/amicus request.htm. *Amicus* briefs submitted by the Commission thus represent the views of the Commission. *See e.g.*, David S. Ruder, *Address: The Development of Legal Doctrine Through Amicus Participation: The SEC Experience*, 1989 Wis. L. Rev. 1167 (1989). All of these steps were taken in this case.[16]

(2d Cir. 2001); *Brief of the Securities and Exchange Commission, Amicus Curiae* at 13-14, *Gryl v. Shire Pharmaceuticals Group PLC.*, 298 F.3d 136 (2d Cir. 2002).

[16] The Commission's staff had detailed meetings with both sides' counsel, made further inquiries of them and received responses, and prepared a detailed written analysis and recommendation. The Commission reviewed

Even when denying deference to a Commission *amicus* brief on other grounds, this Court has said it had "no reason to doubt that the SEC's interpretation was the product of careful consideration." *In re New Times Securities Services, Inc.*, 371 F.3d at 82.

The statutory interpretation in this brief is an authoritative and fully considered position by the Commission, which reasonably construes an ambiguous statutory provision whose interpretation was explicitly entrusted by Congress to the Commission. We believe that the views expressed in this brief are entitled to Chevron deference.

CONCLUSION

The judgment of the district court should be affirmed and the positions of the Commission urged above should be adopted by the Court.

Respectfully submitted,

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February, 2006

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the recommendation for three weeks, met and discussed it, and then voted to authorize the brief. It also reviewed the brief itself.

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

No. 05-0115-cv

AT HOME CORPORATION,
Plaintiff-Appellant,

v.

COX COMMUNICATIONS, INC., COX@HOME, INC., COMCAST CORPORATION, COMCAST ONLINE COMMUNICATIONS, INC., COMCAST PC INVESTMENTS, INC., BRIAN L. ROBERTS AND DAVID M. WOODROW,
Defendants-Appellees.

CERTIFICATE OF COMPLIANCE WITH F.R.A.P. 32(a)

I certify that THE BRIEF OF THE SECURITIES AND EXCHANGE COMMISSION, *AMICUS CURIAE*, SUBMITTED AT THE REQUEST OF THE COURT complies with the type-volume requirements of Rules 32(a)(7)(B) and 29(d) of the Federal Rules of Appellate Procedure (F.R.A.P.) because it contains 6988 words. I further certify that this brief complies with the typeface requirements of F.R.A.P. 32(a)(5) and the type style requirements of F.R.A.P. 32(a)(6) because it has been prepared in proportionally-spaced typeface using WordPerfect (version 11) in garamond 14-point font size.

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CERTIFICATE OF COMPLIANCE WITH LOCAL RULE 32(a)(1): BRIEFS IN DIGITAL FORMAT

I certify that THE BRIEF OF THE SECURITIES AND EXCHANGE COMMISSION, *AMICUS CURIAE*, SUBMITTED AT THE REQUEST OF THE COURT, as submitted in digital format, has been scanned for viruses using McAfee VirusScan version 8.0 with signature 4692 of February 8, 2006 and that no viruses have been detected as required by Local Rule 32(a)(1).

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CERTIFICATE OF SERVICE

I, Allan A. Capute, am a member of the bars of Maryland and the District of Columbia, and I hereby certify that on 9th day of February, 2006, I caused to be served two copies of the BRIEF OF THE SECURITIES AND EXCHANGE COMMISSION, *AMICUS CURIAE*, SUBMITTED AT THE REQUEST OF THE COURT, to counsel for the parties of record at the address below, by overnight Federal Express:

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APPENDIX B

SEC Rule 16b-6(b) (17 C.F.R. § 240.16b–6(b))

The closing of a derivative security position as a result of its exercise or conversion shall be exempt from the operation of section 16(b) of the Act, and the acquisition of underlying securities at a fixed exercise price due to the exercise or conversion of a call equivalent position or the disposition of underlying securities at a fixed exercise price due to the exercise of a put equivalent position shall be exempt from the operation of section 16(b) of the Act: *Provided, however*, That the acquisition of underlying securities from the exercise of an out-of-the-money option, warrant, or right shall not be exempt unless the exercise is necessary to comport with the sequential exercise provisions of the Internal Revenue Code (26 U.S.C. 422A).